92-1420

Supreme Court, U.S.
FILED
MAR 1 1993
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

GUY E. McGAUGHEY, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

WILLIAM J. HARTE
Counsel of Record
WILLIAM J. HARTE, LTD.
111 West Washington Street
Suite 1100
Chicago, Illinois 60602
(312) 726-5015
Attorneys for Petitioner

Photex — 444 North Wabash Avenue — Chicago 60611 — 321-0223

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Court should overrule its earlier cases, decided in 1930 and 1931, to the extent that those cases support the position that a taxpayer's agreement to waive the statute of limitations, given in exchange for the agreement of the Government to consider an offer of compromise, creates a waiver even when the Government's promise is merely illusory.

2. Whether the cases referred to above should be clarified to avoid the obvious unfairness of enforcing the waiver by the taxpayer even though the Government gave nothing in return.

3. Whether the Court of Appeals misapprehended the facts in finding that the taxpayer's newly found evidence was in his possession at all times.

4. Whether the "Ferrell Rule" should have been applied to admit newly discovered evidence which clearly contradicted the Government's position.

PARTIES TO THE PROCEEDINGS IN THE UNITED STATES DISTRICT COURT AND IN THE UNITED STATES COURT OF APPEALS

The only parties in this matter, both in the United States District Court and in the United State Court of Appeals were:

Plaintiff: United States of America

Defendant: Guy E. McGaughey, Jr.

TABLE OF CONTENTS

Questions Presented for Review i

Parties to the Proceedings in the United States District Court and in the United States Court of Appeals 1

Table of Contents 2

Appendix 2

Table of Authorities 3

Citations to the Opinions Below 5

Jurisdictional Statement 8

Constitutional and Statutory Provisions Involved 9

Statement of the Case 11

Argument 17

Conclusion 32

APPENDIX

April 1, 1991 Order of the United States District Court for the Southern District of Illinois . . . . . App. 1

July 10, 1991 Order of the United States District for the Southern District of Illinois . App. 20

October 13, 1992 Opinion of the United States Court of Appeals for the Seventh Circuit . . . . App. 27

January 25, 1993 Order of the United States court of Appeals for the Seventh Circuit . . . . App. 65

TABLE OF AUTHORITIES

Cases

Ferrell v. Trailmobile, Inc., 223 F.2d 697 (5th Cir. 1955) 16

Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930) 17

Giffin v. Commissioner of Internal Revenue, T.C. Memo. 1992-253 (1992) 24

Kronish v. Commissioner of Internal Revenue, 980 T.C. 684 (1988) 25

Niedland v. United States, 338 F.2d 254 (3rd Cir. 1964) 31

Shook & Fletcher Insulation Company v. Central Rigging & Contracting Corporation, 684 F.2d 1383 (11th Cir. 1982) 31

Stange v. United States, 282 U.S. 270 (1931) 16

United States v. Harris Trust & Sav. Bank, 380 F.2d 285 (7th Cir. 1968) 20

United States v. Philatelic Leasing, Ltd., 794 F.2d 781 (2nd Cir. 1986) 31

Other Authorities

Williston on Contracts, § 103 (3rd Ed. 1957) 24

CITATIONS TO OPINIONS BELOW

Plaintiff (hereinafter, the "Government") filed a single count complaint in the United States District Court for the Southern District of Illinois on December 22, 1987, against Guy E. McGaughey, Jr. (hereinafter "McGaughey" "Taxpayer"), seeking judgment against the Taxpayer for $2,368,068.00 plus interest from December 31, 1987, for tax assessments made against the Taxpayer in 1972 and 1977. (R. Doc. 1).

The Taxpayer filed an answer on February 6, 1988, containing a general denial and various affirmative defenses, including that the Government's claim was barred by the Statute of Limitations. (R. Doc. 6).

On May 23, 1990, the Government filed a motion for summary judgment. (R. Doc.

66). The Taxpayer filed a motion for summary judgment on July 16, 1990. (R. Doc. 71).

In a Memorandum and Order dated April 1, 1991, the District Court denied the Taxpayer's motion for summary judgment and granted the Government's motion for summary judgment. (R. Doc. 95). Judgment was entered against the Taxpayer in the amount of $3,410,060.07. (R. Doc. 96).

On April 11, 1991, the Taxpayer filed a motion to alter or amend judgment (R. Doc. 98). (R. Doc. 97).

On May 9, 1991, the Taxpayer filed his addition to the motion to alter or amend the judgment, to which were attached the affidavits of Guy E. McGaughey, Jr., and Andre Zigoris and a copy of the 1977 Offer in Compromise recently discovered by

the Taxpayer, in which the pre-printed waiver of the statute of limitations had been stricken. (R. Doc. 101). On May 16, 1991, the Taxpayer filed a supplemental affidavit in support of his motion to alter or amend judgment. (R. Doc. 102).

On May 22, 1991, the Government filed its response to the Taxpayer's motions. (R. Doc. 103, 104).

On July 10, 1991, the District Court denied the Taxpayer's motions to alter or amend the judgment and to reopen the judgment. (R. Doc. 106).

The Taxpayer filed a notice of appeal on August 7, 1991. (R. Doc. 107). On October 13, 1992, the United States Court of Appeals for the Seventh Circuit issued its Opinion affirming the District Court.

On October 27, 1992, Taxpayer filed a timely petition for rehearing, with

suggestion for rehearing en banc. That petition was denied January 25, 1993.

The opinions of the District Court and of the Court of Appeals appear in the appendix to this Petition.

JURISDICTIONAL STATEMENT

This Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254. The Court of Appeals Opinion was filed October 13, 1992. On October 27, 1992, the Taxpayer filed a timely petition for rehearing before the United States Court of Appeals for the Seventh Circuit. That petition for rehearing contained a suggestion for rehearing en banc. The petition was denied January 25, 1993. Pursuant to 28 U.S.C. 2101(c) and United States Supreme Court Rules 13.1 and 13.4, the present petition is timely and appropriate for consideration by this Court. By operation

of Rule 13.4, the time for filing of this Petition runs from January 25, 1993, the denial of the petition for rehearing.

The jurisdiction of the District Court was invoked pursuant to 26 U.S.C.§1340 and §1345.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. 26 U.S.C. 6502(a):

> Where the assessment of any tax imposed by this title has been made within the period of limitations properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun--
>
> (1) within 6 years after the assessment of the tax, or
>
> (2) prior to the expiration of any period for collection agreed upon in writing by the Secretary and the taxpayer before the expiration of such 6-year period....

2. Treasury Regulation 3.01.6502-1(a)(2)(i):

The 6-year period limitation on collection after assessment of any tax may, prior to the expiration thereof, be extended for any period of time agreed upon in writing by the taxpayer and the district director. The extension shall become effective upon execution of the agreement by both the taxpayer and the district director.

3. Treasury Regulation 301.7122-1(a):

...(T)he Commissioner may compromise any civil or criminal liability arising under the internal revenue laws prior to reference of a case involving liability to the Department of Justice for prosecution or defense. Any such liability may be compromised only upon one or both of the following grounds:

(1) Doubt as to liability; or

(2) Doubt as to collectability.

No such liability will be compromised if the liability has been established by a valid judgment or is certain and there is no doubt as to the ability of the Government to collect the amount owing with respect to liability.

STATEMENT OF THE CASE

On December 25, 1972, the Secretary of the Treasury assessed the Taxpayer $573,563.63 for tax deficiencies for the years 1962, 1964, 1965, 1966 and 1967. This assessment was made pursuant to a decision of the United States Tax Court, rendered August 21, 1972.

The statute of limitations applicable to collection of such taxes, is set forth in 26 U.S.C. 6502(a):

> Where the assessment of any tax imposed by this title has been made within the period of limitations properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun-
>
> (1) within 6 years after the assessment of the tax, or
>
> (2) prior to the expiration of any period for collection agreed upon in writing by the Secretary and the taxpayer before the expiration of such 6-year period....

Treasury Regulation ("T.R.") 301.7122-1(a) provides for possible compromise of a claimed tax liability upon one or both of two grounds: (1) that there is a doubt as to liability for the tax; and (2) that there is a doubt as to collectability of the tax.

On June 6, 1977, an offer in compromise, based on a "doubt as to liability" (the "1977 offer") was submitted. The printed form on which the offer was made includes a waiver of the statute of limitations. By letter dated March 23, 1978, the 1977 offer was rejected by the IRS, which stated that it had no authority to accept the offer in compromise based on "doubt as to liability" when a Tax Court decision had already been rendered. The Government's manual requires that such an offer be

summarily rejected under these circumstances.

On December 27, 1987, the Government filed a complaint seeking judgment against the Taxpayer for the claimed unpaid taxes. The Taxpayer answered and raised the defense of the expiration of the statute of limitations as to the taxes assessed on December 25, 1972. The Taxpayer argued first that there was no waiver of the statute of limitations by the Taxpayer in the 1977 offer, and second, that any such waiver would have been legally ineffective, so that summary judgment should be entered in his favor. Regarding the legal validity of the waiver, even had it been included with the 1977 offer, the Taxpayer argued that since the waiver was given in exchange for the Government's agreement to consider the 1977 offer, and

the Government could not, by its own rules, consider the offer, the waiver was a nullity.

The Government argued, in support of its motion for summary judgment, that the Taxpayer had waived the statute of limitations in his 1977 offer. However, the Government had destroyed the 1977 offer. The Government produced neither the original offer nor a copy. Nor did the Taxpayer have a copy to produce.

The District Court granted summary judgment in favor of the Government and against Taxpayer. The Taxpayer filed a timely motion to alter or amend the judgment pursuant to F.R.C.P. 59(e).

Attached to an addition to this motion was the Taxpayer's affidavit, and the affidavit of Andre Zigoris, recounting Mr. Zigoris' recent discovery of a copy of

the original 1977 offer. The District Court considered the submission as a motion to re-open judgment because of newly discovered evidence, pursuant to F.R.C.P. 60(b)(2).

The copy of the 1977 offer showed that the waiver of the statute of limitations had been crossed out of the printed form, indicating that the Taxpayer did not agree to extend the statute of limitations.

On July 11, 1991, the District Court, despite this copy of the 1977 offer, refused to vacate the summary judgment entered in the Government's favor. The District Court held that the Taxpayer did not exercise due diligence in locating the 1977 offer, reasoning that the "evidence was within the reach and control of the defendant and allegedly located within his

own files." On October 13, 1992, the United States Court of Appeals affirmed the District Court.

The Court of Appeals explained that the Taxpayer's "argument relies heavily upon contractual principals, which we have indicated have no place in determining the validity of the waiver." United States v. McGaughey, 977 F.2d 1067 (7th Cir. 1992) Concerning the Taxpayer's reliance on Ferrell v. Trailmobile, Inc., 223 F.2d 697 (5th Cir. 1955) (practically conclusive evidence may require a new trial if proper diligence was not used to secure the evidence during the trial), the Court of Appeals declined to apply Ferrell, and stated that the "rule does not appear to have been formally adopted in this circuit." McGaughey, 977 F.2d at 1076 .

Jurisdiction was conferred upon the United States District Court for the Southern District of Illinois by 26 U.S.C. §7402(a) and by 28 U.S.C. §1340 and 1345.

ARGUMENT

I. THE CASES RELIED UPON BY THE COURT OF APPEALS, SHOULD BE OVERRULED OR CLARIFIED, TO THE EXTENT THAT THEY HOLD THAT A TAXPAYER'S AGREEMENT TO WAIVE A STATUTORY RIGHT, IN EXCHANGE FOR A PROMISE BY THE GOVERNMENT TO DO SOMETHING IN RETURN, CREATES AN ENFORCEABLE WAIVER EVEN THOUGH THE GOVERNMENT'S PROMISE IS MERELY ILLUSORY.

This case offers this Court the opportunity to overrule, or at least to clarify, the broad holdings of Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930), and Stange v. United States, 282 U.S. 270 (1931). While the statement in Florsheim and Stange that a waiver itself is not a contract is true, the taxpayer submits that a waiver can be part of a contract when it is given in

exchange for, or in consideration of, the promise by another to take certain actions. This Court should take this opportunity to overrule Florsheim and Stange, insofar as is necessary to avoid the clear unfairness to the taxpayers of this country that arises when the Government can induce a taxpayer to waive the statute of limitations by appearing to promise something in exchange for the waiver when, in fact, the Government's promise is a sham or illusory.

This Court should overrule Florsheim and Stange, to the extent that those cases may seem to have held that, because a waiver is not a contract, but a voluntary unilateral waiver of a defense, the Government can make an illusory promise to a taxpayer in order to induce the taxpayer to execute the waiver. Because such a

result is clearly unfair, such a rule should be overruled.

In the alternative, this Court should further clarify Florsheim and Stange to limit Florsheim and Stange to those situations where a party intended a voluntary waiver, one freely given without consideration.

By clarifying Florsheim and Stange this Court will also resolve inconsistent applications of the rule of those cases among the circuits. As stated by the Court of Appeals, contract principles have been utilized by some circuits in analyzing waivers, explaining that "courts have, in limited contexts, utilized contractual analysis to solve problems related to waivers[.]" McGaughey, 977 F.2d at 1072. However, the Court of Appeals declined to do so in this case.

In United States v. Harris Trust & Sav. Bank, 380 F.2d 285 (7th Cir. 1968), the Seventh Circuit adopted the reasoning of the Eighth Circuit, which had used contract principles to resolve the very question at issue in this case. The Harris court, considering paragraph 6 of IRS Form 656 (the paragraph regarding waiver of the statute of limitations in the Government's form for offers in compromise), held:

> The purpose of the suspension clause of Item 6 and of the Treasury Regulation is to allow the Government a reasonable time to consider offers, without prejudicing its right to collect the tax as a result of this consideration. As pointed out in United States v. Havner, 101 F.2d 161 (8th Cir. 1939), the suspension of the statute of limitations is the quid pro quo for the Government's considering a compromise offer. Judge Sanborn explained (at 63): "The taxpayer, in submitting such an offer and waiver, in effect requests the Government to withhold attempts to collect the tax while the offer is pending, and, in consideration of

> this forbearance on the part of the Government, consents to forego the benefit of having the statute of limitations run while his offer of settlement is pending."

Harris Trust, 390 F.2d at 288.

The Taxpayer submits that the Court of Appeals' decision regarding his waiver of the statute of limitations, in the context of 26 U.S.C. §6502(a) and 26 C.F.R. §301-6502.1(2), is in conflict with the same court's decision in Harris.

In the instant case, the same Court of Appeals which recognized the appropriateness of the use of contract principles in Harris, held:

> Even if the IRS' ability to accept the offer was proscribed by law, and even if this waiver would be invalid if contract principles were applied, the waiver is valid because contract principles do not apply and because the IRS did consider the offer, even though its rejection was preordained.

McGaughey, 977 F.2d at 1073. The Taxpayer respectfully submits that the court below

both declined the use of contract principles and then improperly applied contract principles, in deciding this case. The decision conflicts with Harris and with logic.

The Court of Appeals suggests that "McGaughey agreed to suspend the statute of limitations, and the IRS agreed to consider his offer." McGaughey, 977 F.2d at 1073. However, the IRS clearly did not consider the offer, because it could not do so.

T.R. 301.7122-1(a) provides:

> . . . [T]he Commissioner may compromise any civil or criminal liability arising under the internal revenue law prior to reference of a case involving liability to the Department of Justice for prosecution or defense. Any such liability may be compromised only upon one or both of the following grounds:
>
> (1) Doubt as to liability; or
>
> (2) Doubt as to collectability.

> No such liability will be compromised if the liability has been established by a valid judgment or is certain, and there is no doubt as to the ability of the Government to collect the amount owing with respect to liability.

Here there was no doubt as to liability, because a judgment had been entered. Therefore, an offer in compromise based on doubt as to liability should not have been accepted, because any agreement by the Government to give such an offer true consideration was illusory. The Government could not, and did not, "consider" the Taxpayer's offer. "Consider", means "to deliberate upon; examine; study." THE AMERICAN HERTIAGE DICTIONARY 284 (New College Edition 1981). Because rejection of the Taxpayer's offer was preordained, the Government could not have deliberated or studied the offer.

Therefore, the apparent agreement was illusory. A promise which the promisor is legally forbidden to make is no promise at all. It is said to be an illusory promise and furnishes no consideration. Williston, Williston on Contracts, §103, at 388-389 (3rd Ed. 1957). Had the lower court properly applied contract principles, the court would have held the 1977 offer ineffective for lack of consideration.

The United States Tax Court has also relied on contract principles in assessing waivers. In Giffin v. Commissioner of Internal Revenue, T.C. Memo. 1992-253 (1992), the court considered "whether the statute of limitations under section 6501 bars the assessment and collection of petitioners' 1982 Federal income tax

deficiency." In answering this issue, the Giffin court explained:

> A taxpayer's consent to extend the period of time for assessment of an income tax beyond the statute of limitations is a unilateral waiver of a defense. The agreement is not a contract. [citations omitted.] However, contractual principles are significant because section 6501(c)(4) requires that the parties reach a written agreement as to the terms of the extension.

Giffin, T.C. Memo. 1992-253. (Emphasis added.) Although the agreement in Giffin differs from the 1977 offer in this case, both included possible extension of the statute of limitations.

Kronish v. Commissioner of Internal Revenue, 980 T.C. 684 (1988), also applied a quid pro quo analysis. In Kronish, the court considered a Form 872 entitled "Consent to Extend the Time to Assess Tax." The court first cited Stange and stated "a consent to extend the period of

limitations on assessment is not a contract." Kronish, 980 T.C. 684. Thereafter, the court recognized that the use of contract principles was appropriate and relied on Williston. "It is the objective manifestation of mutual assent as evidenced by the parties' overt acts, not the parties' secret intentions, that determines whether the parties have made an agreement." Kronish, 980 T.C. 684, (citing 1 S. Williston, Contracts, secs. 22 and 35 (3d Ed. 1957)).

Because of the holdings in Florsheim and Stange, the trial and appellate courts have been constrained to point out that "waivers" are not "contracts". Yet some courts go on to analyze the execution of waivers in light of contract principles, clearly in an attempt to honor the intentions of the parties to exchange one

promise for another. Therefore, the Taxpayer respectfully asks this Court to clarify this area of the law, and to overrule Florsheim and Stange to the extent that they appear to hold that a taxpayer's waiver of the statute of limitations, ostensibly given in exchange for the Government's promise to do something in exchange, is effective even though the Government's promise is illusory. Thus, the Court will enable a straight-forward analysis, based on the specific wording of the individual agreements between taxpayers and the Government.

II. THE TAXPAYER EXERCISED DUE DILIGENCE IN ATTEMPTING TO LOCATE THE 1977 OFFER.

The Taxpayer exercised due diligence in searching for the original 1977 offer, and therefore pursuant to F.R.C.P.

60(b)(2) the Taxpayer should have been relieved of the judgment against him. There are eight prerequisites to the re-opening of a judgment pursuant to Rule 60(b)(2), only one of which the district court found wanting, due diligence. Because the district court misapprehended the facts surrounding the Taxpayer's diligence and the Court of Appeals relied on this misapprehension, the Court of Appeals erred in its holding.

The Court of Appeals stated:

> [G]iven the importance of the document, one would have expected McGaughey to search all of his papers. The fact that the document was in McGaughey's possession throughout the pendency of the proceedings below further belies McGaughey's claim of diligence. McGaughey, 977 F.2d at 1075.

The above is at odds with the affidavit of the Taxpayer's stepson, Andre Zigoris, the

person who found the copy of the 1977 offer.

In his affidavit Mr. Zigoris stated he "found three old, dusty folders on or about April 16, 1991, which appeared to be unrelated to old boxes in which they were found," and that the 1977 offer was found in one of the folders. Mr. Zigoris stated he was searching files belonging to Guy McGaughey, Sr., J.E. McGaughey, McGaughey & McGaughey, Ltd., and the files of Guy E. McGaughey, Jr. (the Taxpayer), from Mid-City Mall. Mr. Zigoris' affidavit does not specifically state the 1977 offer was found within the Taxpayer's papers, or within his possession.

Consequently, the district court could not have based its finding that the 1977 offer was in the Taxpayer's possession or among his files on the

evidence. Therefore, the Court of Appeals misapprehended the facts in affirming the district court.

III. THE COURT SHOULD ADOPT AND ENDORSE THE "FERRELL RULE."

However, even if there had been a lack of due diligence, the judgment should have been vacated. The Court of Appeals failed to apply the so-called "Ferrell Rule," an important exception to Rule 60(b)(2). Where the evidence is virtually determinative of the merits of the litigation, a lack of due diligence need not preclude the introduction of the new evidence. Ferrell v. Trailmobile, Inc., 223 F.2d 697, 698 (5th Cir. 1955).

This case offers this Court the opportunity to examine Ferrell and the Rule. The Ferrell Rule is an exception to the "due diligence" requirement of a 60(b)(2) motion. F.R.C.P., 28 U.S.C.A.

> If, in fact, practically conclusive evidence shows that the appellant had actually paid all eighteen installments...it is obvious that the judgment should be set aside to prevent a manifest miscarriage of justice. In such a case, the ends of justice may require granting a new trial even though proper diligence was not used to secure such evidence for use at trial.

Ferrell, 223 F.2d at 698. Although several circuits have considered Ferrell, there is a lack of clarity among the circuits as to the rule's standing.

The "Ferrell Rule" has been cited by the Second Circuit (United States v. Philatelic Leasing, Ltd., 794 F.2d 781, 788 (2nd Cir. 1986)), the Third Circuit, (Niedland v. United States, 338 F.2d 254, 260 (3rd Cir. 1964)), and the Eleventh Circuit, (Shook & Feltcher Insulation Company v. Central Rigging & Contracting Corporation, 684 F.2d. 1383, 1385 (11th Cir. 1982)). The Seventh Circuit in the

case below declined to adopt the rule. McGaughey, at 977 F2.d at 1076.

Because the "Ferrell Rule" is an important exception to the requirement of due diligence, this Court should finally decide the rule's validity and applicability and should hold that the rule is applicable here.

CONCLUSION

This case merits consideration by this Court to resolve the inconsistencies reached in the cases regarding taxpayers' waivers of statutory rights and to announce the Court's acceptance or rejection of the Ferrell rule.

Respectfully submitted,

WILLIAM J. HARTE
WILLIAM J. HARTE, LTD.
111 West Washington Street
Chicago, IL 60602
(312) 726-5015